

**FEDERATED STATES OF MICRONESIA
PETROLEUM CORPORATION**

**(A COMPONENT UNIT OF THE FSM NATIONAL
GOVERNMENT)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2014 AND 2013

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Years Ended December 31, 2014 and 2013
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Petroleum Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia (FSM) Petroleum Corporation (the Corporation), and its discretely presented component unit, collectively a component unit of the FSM National Government, which comprise the respective statements of net position as of December 31, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position and, where applicable, cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as set forth in Section III of the foregoing table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Corporation and its discretely presented component unit as of December 31, 2014 and 2013, and the respective changes in financial position and, where applicable, cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

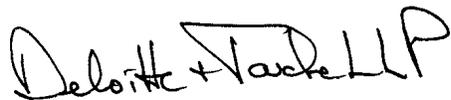
Other Matters

Required Supplementary Information:

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2015, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 22, 2015

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION (A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Management's Discussion and Analysis
Years Ended December 31, 2014 and 2013

STRATEGIC OBJECTIVES

The primary long term role and function of the Federated States of Micronesia Petroleum Corporation (FSMPC or “the Corporation”) is to secure a stable supply of petroleum products to meet the nation’s core energy needs. The Corporation engages efficiently, responsibly and profitably in the sector. This ensures that there are sufficient resources to maintain assets, train people, hold strategic oil inventories, and provide petroleum products in full, on-time, and to international specifications.

The Corporation is the largest supplier of energy in the FSM and constantly evaluates opportunities to expand vertically into markets which use and supply modern energy services, as well as laterally into alternative energy technologies with an aim of improving the energy security of the nation.

In addition, as a result of Public Law 18-68 the Corporation transitioned the assets, staff and operations of the FSM Coconut Development Authority (CDA) in September 2014.

SUMMARY OF OPERATIONS

Locations

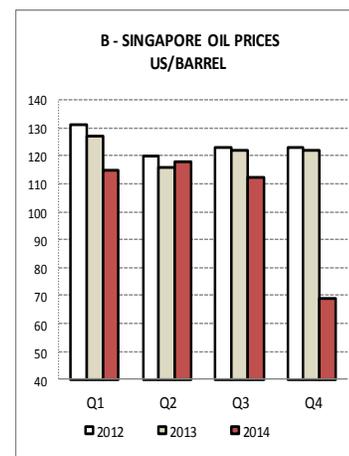
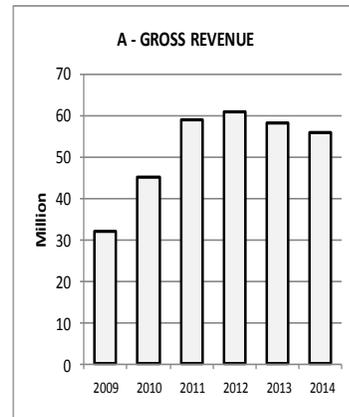
In the FSM, the Corporation operates a total of six fuel terminal facilities in the States of Yap, Chuuk, Kosrae, and Pohnpei, and services the international aviation, marine bunkering, and inland market segments. It also owns and operates a copra and coconut processing facility in Pohnpei producing soaps and edible oils.

In February 2012, Vital Energy (Guam) Incorporated was established. In June 2012, it was successful in securing a terminal operations and management contract with the Guam Power Authority (GPA). Across the seven fuel facilities the Corporation now store, handle and deliver over 2.3 million barrels of petroleum products per annum.

Revenues

Gross revenues for CY 14 were \$56.1 million, reflecting a decrease of \$2.6 million on 2013 (refer graph A). The Pricing Policy Framework (PPF) used by the Corporation automatically matches input price decreases with sales price reductions. In CY14, the decrease in revenue is attributed equally to both depressed sales volumes as well as lower output prices for the second consecutive year. International oil prices commenced at \$114/bbl and was dropped to around \$70/bbl at the end 2014. The international average price for 2014 was \$108/bbl, approximately \$8/bbl lower than 2013 (graph B).

Gross revenue contributions by State were Kosrae 10%, Yap 15%, Chuuk 25% and Pohnpei 50%, with a product mix of automotive diesel oil 46%, unleaded petrol (or gasoline) 38%, home kerosene and Jet A1 of 12%. Non-fuel related revenues from power plant electricity sales, as well as coconut related products were approximately 4% of total revenues.



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Our petroleum operations throughout the FSM and Guam and are supported by fuel, lubricant and technical service agreements with Mobil Oil Micronesia Incorporated (MOGI), Total Oil Asia Pacific (TOAP), and ExxonMobil Aviation (EMA). There have been no change to our suppliers of core products and our fuel supply contracts have remained unchanged.

Business Planning

The business continues to conduct itself in accordance with the standards set out in the Statement of General Business Principles (SGBP). Management seeks formal reassurance from each staff member that they operate within these principles annually. The Board confirms their commitment to the SGBP annually. There were no reported breaches of these principles in 2014.

The Corporation maintains an annual business plan that sits firmly within a five-year development window defined by our Strategic Plan that is aligned with national and state energy policies that are in effect. The Strategic Plan is due for a comprehensive review in 2015.

Risk Management

Risks continue to be managed proactively. A Board Committee on Risk and Audit has been established with a defined Charter, and a quarterly meeting schedule. The Committee on Risk and Audit are accountable for the review and progress of all remedial action plans across the business. Resource allocation continues to be heavily weighted towards risk mitigation. The three areas that are currently a priority for the corporation are i) competent people, ii) asset rehabilitation, and iii) credible scenario planning and preparedness.

The risk management system is compliant with the ISO31000:2009 international standard for Risk Management. The Corporation has adopted the most recent American Petroleum Institute Standard 653 (API653) for maintenance of petroleum storage tanks, and also seeks to comply with the Joint Implementation Group (JIG) standard for international airports.

Domestic Pricing

In 2014 the Pricing Policy Framework (PPF) was revised to incorporate the favorable terms of the 2013 Fuel Supply Agreement. The 2014 PPF saw savings from fuel procurement passed on to State Utilities. The PPF continues to provide a mechanism to stabilize domestic prices and to cushion the effect of international volatility. There are no cross subsidies within the PPF, and the prices in each State reflect the costs of procuring, financing, storing, handling and distribution of fuels in that State.

The Corporation continues to benchmark domestic price competitiveness through comparison of pump prices of island neighbors. Throughout CY14, domestic prices compared favorably with Guam, with the observable pump price difference maintained below \$0.35 per gallon. The PPF maintains a monthly price change for contract customers such as utilities and airlines, and quarterly price changes to retail service stations. This strategy continues to provide stable energy prices for homes, business, and government.

Financial Condition

The Corporation continues to invest all operating surplus into the retirement of long term notes and capital improvement projects that are for mandatory compliance, reduction of operating risk, improvement of profitability, driving operational efficiency or strategic in nature. There is work underway to further align our investment decisions with the intent and direction of the 2012 FSM Energy Policy.

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There is a noticeable improvement in the condition and asset value of our oil distribution infrastructure as well as the levels of strategic oil inventory that maintains the current energy security of the nation and the current policies have also positively impacted our debt-to-equity ratio. We are now able to attract competitive long term financing to fund our proposed investments and obligations in the agricultural sector, as well as Phase II of the Asset Rehabilitation Program.

The following table summarizes the Corporation's financial position and results of operations as of the and for the year ended December 31, 2014, 2013, and 2012.

Assets:	<u>2014</u>	<u>2013</u>	<u>2012</u>
Capital Assets, net	\$ 16,692,475	\$ 15,725,689	\$ 12,117,382
Cash	13,878,521	7,753,522	7,736,760
Inventory, net	7,568,958	8,052,909	4,731,901
Receivables & other current assets	<u>4,643,377</u>	<u>4,999,999</u>	<u>5,964,968</u>
Total Assets	<u>\$ 42,783,331</u>	<u>\$ 36,532,119</u>	<u>\$ 30,551,011</u>
Liabilities and Net Position:			
Current liabilities	\$ 8,208,953	\$ 5,725,434	\$ 2,923,823
Noncurrent liabilities	2,284,049	2,320,659	3,646,672
Net position	<u>32,290,329</u>	<u>28,486,026</u>	<u>23,980,516</u>
Total Liabilities & Net Position	<u>\$ 42,783,331</u>	<u>\$ 36,532,119</u>	<u>\$ 30,551,011</u>
Revenues, Expenses and Changes in Net Position:	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenues	\$ 56,114,912	\$ 58,768,879	\$ 61,575,499
Cost of goods sold	<u>(43,184,791)</u>	<u>(46,500,495)</u>	<u>(49,649,654)</u>
Gross profit	12,930,121	12,268,384	11,925,845
Operating expenses	(9,112,193)	(7,768,950)	(7,380,238)
Nonoperating (expenses) revenue	<u>(13,625)</u>	<u>6,076</u>	<u>(308,171)</u>
Change in net position	<u>\$ 3,804,303</u>	<u>\$ 4,505,510</u>	<u>\$ 4,237,436</u>

Major changes in the profit and loss and statement of net position components for CY14 are a result of:

- a) The Corporation maintained one-year term Line of Credit with Bank of Guam (BOG) for \$10,000,000. The short term note with banks remained at a zero balance in CY2014 as a result of prudent cash management. The Corporation continues to invest its operating surplus into retirement of long term notes, in capital expenditure to reduce operating risks and strengthen oil distribution infrastructure, and into strategic oil inventory to increase the energy security of the nation;
- b) The higher operating expenses for 2014 are directly attributed to increased activities of the Corporation. These include operation and maintenance of a 2.0MW independent power plant as well as a facility operations and maintenance agreement with Pohnpei Utilities Corporation (PUC).

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Management's Discussion and Analysis
Years Ended December 31, 2014 and 2013

The figures also include the merger of the Coconut Development Authority within the business from September through December;

- c) At the end of December 31, 2014, the Corporation's long-term note payable with Bank of Guam for the initial acquisition of fixed assets from Mobil Oil Micronesia Inc. was paid off;
- d) The total amount received from sales of petroleum products exceeded the amount paid to vendors and employees for goods and services. The net cash provided by operating activities in 2014 was \$9,254,593 as compared to \$5,657,548 in 2013;
- e) A total of \$3,129,594 was used for capital and related investing activities mainly for the purchase of capital assets. The Corporation's total investments in capital assets, inclusive of construction in progress as of December 31, 2014 and 2013 were \$16,692,475 and 15,725,689, respectively, which are net of accumulated depreciation of \$5,214,737 and 3,769,516, respectively.

CAPITAL ASSETS AND LONG-TERM DEBT

Capital Assets: At the end of CY2014, the Corporation had \$16.7 million invested in capital assets. This represents an increase in net capital assets (including additions and deletions) of \$0.9 million or 6% over the previous year. For additional information about the Corporation's capital assets, refer to Note 3 to the financial statements.

Long-Term Debt: The Corporation had a note payable with Bank of Guam, which was paid in full as of December 31, 2014. See Note 5 to the financial statements for additional information.

ECONOMIC OUTLOOK

The impact of the Compact decrement is evident within our petroleum business. Despite domestic energy prices being stable and lower in CY14 as compared to CY13, domestic sales volumes continue a slow and gradual decline. This hints at either a reducing or stressed household budget, few new economic activities, and to a smaller extent, the impact of renewable energy technology on electricity production.

This trend underpins the importance of the Corporation's strategy to diversify its operations and revenue sources both away from fuel and outside of the FSM and COFA impacted countries. At present non-FSM and non-fuel related activities of the Corporation are approximately 5% of overall revenues, with an overall target of 30% within three years. This will come from investment into the restructuring of the coconut industry, the construction of a new integrated coconut processing facility, an additional independent power plant in the Chuuk State, and further geographical expansion outside of FSM borders.

Economic development opportunities in the tourism, agriculture, energy and fisheries sector are abundant. What is the current challenge is that due to a lack-of-scale and the diseconomy-of-isolation, the transaction costs that are necessary convert the 'potential' into 'reality' remains the biggest hurdle for projects in the FSM.

Management's Discussion and Analysis for the year ended December 31, 2013 is set forth in the report on the audit of FSMPC's financial statements, which is dated June 30, 2014. That Discussion and Analysis explains the major factors impacting the 2013 financial statements and may be obtained from the contact show below.

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Management's Discussion and Analysis
Years Ended December 31, 2014 and 2013

CONTACT

Questions associated with the above Management's Discussion and Analysis may be sent by post, addressed to Mr. Mathias Lawrence, Chief Financial Officer, P.O. Box 1762, Kolonia, Pohnpei, FSM 96941 or via email to petrocorp@fsmc.com.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Statements of Net Position
December 31, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets:		
Cash	\$ 13,878,521	\$ 7,753,522
Trade receivables	2,316,386	2,158,241
Inventory, net	7,568,958	8,052,909
Deposit with supplier	478,051	1,560,978
Prepaid expenses	<u>1,348,940</u>	<u>780,780</u>
Total current assets	25,590,856	20,306,430
Restricted cash	500,000	500,000
Capital assets:		
Nondepreciable capital assets	4,445,803	4,985,403
Other capital assets, net of accumulated depreciation	<u>12,246,672</u>	<u>10,740,286</u>
	<u>\$ 42,783,331</u>	<u>\$ 36,532,119</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Current portion of long-term debt	\$ -	\$ 667,352
Accounts payable - fuel	3,987,290	3,275,150
Accounts payable - other	421,037	454,160
Accrued liabilities and others	<u>3,800,626</u>	<u>1,328,772</u>
Total current liabilities	8,208,953	5,725,434
Long-term debt, net of current portion	-	36,610
Due to states and primary government, net of current portion	<u>2,284,049</u>	<u>2,284,049</u>
Total liabilities	<u>10,493,002</u>	<u>8,046,093</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	16,692,475	10,036,324
Unrestricted	<u>15,597,854</u>	<u>18,449,702</u>
Total net position	<u>32,290,329</u>	<u>28,486,026</u>
	<u>\$ 42,783,331</u>	<u>\$ 36,532,119</u>

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Net Position
December 31, 2014 and 2013
Discretely Presented Component Unit

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets:		
Cash	\$ 46,797	\$ 13,547
Receivables	219,426	188,704
Prepaid expenses	3,420	15,391
Total current assets	<u>269,643</u>	<u>217,642</u>
Property and equipment, net	<u>63,417</u>	<u>66,897</u>
	<u>\$ 333,060</u>	<u>\$ 284,539</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Accounts payable	\$ 211,670	\$ 101,524
Accrued liabilities and others	11,960	15,044
Total current liabilities	<u>223,630</u>	<u>116,568</u>
Contingencies		
Net position:		
Net investment in capital assets	63,417	66,897
Unrestricted	46,013	101,074
Total net position	<u>109,430</u>	<u>167,971</u>
	<u>\$ 333,060</u>	<u>\$ 284,539</u>

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Statements of Revenue, Expenses, and Changes in Net Position
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenue:		
Sales and service income	\$ 56,110,709	\$ 58,757,490
Other	4,203	11,389
	<u>56,114,912</u>	<u>58,768,879</u>
Cost of goods sold	<u>43,184,791</u>	<u>46,500,495</u>
Gross profit	<u>12,930,121</u>	<u>12,268,384</u>
Operating expenses:		
Salaries and benefits	1,591,168	1,338,920
Taxes	1,583,283	1,716,612
Depreciation	1,445,221	935,734
Rent	669,771	520,268
Professional fees	644,479	582,196
Repairs and maintenance	625,554	387,504
Staff travel, training and development	575,174	438,409
Insurance	351,738	396,055
Contracted services	302,574	195,302
Corporate governance	262,011	356,362
Office supplies	255,650	139,324
Utilities	220,885	196,368
Communications	212,075	243,151
Fuel	86,716	100,326
Miscellaneous	285,894	222,419
Total operating expenses	<u>9,112,193</u>	<u>7,768,950</u>
Operating income	<u>3,817,928</u>	<u>4,499,434</u>
Nonoperating revenues (expenses):		
Contributions to component unit	-	-
Interest income (expense), net	<u>(13,625)</u>	<u>6,076</u>
Total nonoperating revenues (expenses), net	<u>(13,625)</u>	<u>6,076</u>
Change in net position	3,804,303	4,505,510
Net position at beginning of year	<u>28,486,026</u>	<u>23,980,516</u>
Net position at end of year	<u>\$ 32,290,329</u>	<u>\$ 28,486,026</u>

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Revenue, Expenses, and Changes in Net Position For the years ended December 31, 2014 and 2013 Discretely Presented Component Unit

	2014	2013
Operating revenue:		
Service income	\$ 747,471	\$ 737,082
Cost of services	(71,558)	(57,870)
Gross profit	675,913	679,212
Operating expenses:		
Salaries and benefits	208,671	200,321
Contracted services	126,922	123,060
Utilities	124,030	131,607
Professional fees	69,726	66,631
Insurance	48,393	50,463
Guam gross receipt tax	32,736	24,761
Rent	30,885	21,426
Depreciation	18,094	13,431
Repairs and maintenance	16,066	6,528
Communications	13,035	13,360
Bank charges	11,789	6,789
Office supplies	9,523	14,615
Staff training and development	9,054	4,579
Fuel	7,042	8,069
Travel and entertainment	1,105	2,630
Miscellaneous	7,383	9,412
Total operating expenses	734,454	697,682
Operating loss	(58,541)	(18,470)
Change in net position	(58,541)	(18,470)
Net position at beginning of the period	167,971	186,441
Net position at end of the period	\$ 109,430	\$ 167,971

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Cash received from customers	\$ 56,024,719	\$ 58,552,863
Cash paid to suppliers for goods and services	(45,178,958)	(51,561,142)
Cash paid to employees for services	<u>(1,591,168)</u>	<u>(1,334,173)</u>
Net cash provided by operating activities	<u>9,254,593</u>	<u>5,657,548</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(2,412,008)	(4,449,194)
Principal repayment of long-term debt	(703,962)	(1,102,821)
Interest paid	<u>(13,624)</u>	<u>(88,771)</u>
Net cash used for capital and related financing activities	<u>(3,129,594)</u>	<u>(5,640,786)</u>
Net change in cash	6,124,999	16,762
Cash at beginning of year	<u>7,753,522</u>	<u>7,736,760</u>
Cash at end of year	<u>\$ 13,878,521</u>	<u>\$ 7,753,522</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 3,817,928	\$ 4,499,434
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,445,221	935,734
(Increase) decrease in assets:		
Trade receivables	(158,145)	(148,064)
Inventory and related deposit with supplier	1,566,878	(2,021,919)
Prepaid expenses	(568,160)	(186,056)
Increase (decrease) in liabilities:		
Accounts payable	679,017	2,705,975
Accrued liabilities and others	2,471,854	15,913
Due to states and primary government	<u>-</u>	<u>(143,469)</u>
Net cash provided by operating activities	<u>\$ 9,254,593</u>	<u>\$ 5,657,548</u>
Supplemental schedule of noncash investing activities:		
Interest expense capitalized during construction	<u>\$ -</u>	<u>\$ 94,847</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

(1) Organization and Basis of Presentation

Federated States of Micronesia Petroleum Corporation (FSMPC or the Company) is a component unit of the Federated States of Micronesia (FSM) National Government (FSMNG). FSMPC was created under Public Law 15-08, as passed by the FSM Congress and which was signed into law on September 11, 2007, for the purpose of providing oil and gas distribution for the entire FSM.

FSMPC is governed by a seven-member Board of Directors appointed as follows:

- 1 member appointed by the President with the advice and consent of the FSM Congress to represent the FSMNG.
- 4 members appointed by each State governor to represent each of the States.
- 2 members from the private sector, appointed by the President with the advice and consent of the FSM Congress.

FSMPC's financial statements are incorporated into the financial statements of the FSM National Government as a component unit.

Basis of Accounting

The accounts of FSMPC are organized as a discretely presented component unit - proprietary fund of the FSM National Government. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to a private business. This accounting is appropriate when costs of providing goods or services to the general public are to be financed primarily through user charges or where the periodic determination of net income is appropriate for accountability purposes. The accrual basis of accounting is utilized by proprietary funds. Under the accrual basis, revenues are recorded when earned, and expenses are recorded at the time the liabilities are incurred.

FSMPC utilizes the flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Statement of Net Position presents all of the FSMPC's non-fiduciary assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Net position is classified for accounting and reporting purposes into the following four net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets as well as deferred outflows of resources and deferred inflows of resources that are attributable to those assets or related debt.
- Restricted - restricted assets reduced by liabilities and deferred inflows of resources related to those assets that are subject to externally imposed stipulations.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements
December 31, 2014 and 2013

(1) Organization and Basis of Presentation, Continued

Basis of Accounting, Continued

- Unrestricted - the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Operating revenues and expenses generally result directly from the operation and maintenance of the Company. Non-operating revenues and expenses result from capital and related financing activities as well as certain other non-recurring income and expense items.

Reporting Entity

Vital Energy, Inc. (Vital) is a legally separate entity which meets the criteria set forth for component units. Vital was incorporated on February 10, 2012 for the purpose of carrying on the operation of importation and sale of petroleum products, and operation, management and maintenance of petroleum storage terminals, international marine bunkering services, operation of road and aviation bridging tankers, and aviation refueling operations. Vital's fiscal year-end is as of December 31. Copies of Vital's report can be obtained by contacting Vital management. Vital's significant notes are summarized in Note 21.

(2) Summary of Significant Accounting Policies

A. Cash

Custodial credit risk is the risk that in the event of a bank failure, the Company's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. FSMPC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position and of cash flows, cash represents cash on hand and cash in bank accounts. Cash in bank accounts externally restricted for use are separately classified. As of December 31, 2014 and 2013, total carrying amounts of cash were \$14,378,521 and \$8,253,522, respectively, and the corresponding bank balances were \$14,452,410 and \$8,304,573 respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2014 and 2013, bank deposits in the amount of \$250,000 were subject to FDIC insurance. Balances in excess of FDIC insurance are not collateralized.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements
December 31, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

B. Accounts Receivable

Accounts receivable are due from businesses and individuals located in the Federated States of Micronesia and are interest free and uncollateralized, except those from utility companies. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. Bad debts are written-off against the allowance based on the specific identification method. At December 31, 2014 and 2013, the Company is of the opinion that an allowance for doubtful accounts is not required.

C. Inventory

Inventory is substantially carried at the lower of cost (moving average cost) or market value. At December 31, 2014 and 2013, inventory consists of the following:

	<u>2014</u>	<u>2013</u>
Inventory on hand:		
Fuel	\$ 4,662,824	\$ 7,647,286
Lubricants	370,933	362,456
Chemicals	<u>145,715</u>	<u>93,754</u>
	5,179,472	8,103,496
Inventory in transit:		
Fuel	<u>2,440,073</u>	<u>-</u>
	7,619,545	8,103,496
Less allowance for obsolescence	<u>(50,587)</u>	<u>(50,587)</u>
	<u>\$ 7,568,958</u>	<u>\$ 8,052,909</u>

D. Property, Plant and Equipment

The Company capitalizes individual items with estimated useful lives of more than one year without regard to a capitalization threshold. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Buildings	15 years
Motor vehicles	5 years
Plant and equipment	3 to 15 years
Furniture and fixtures	4 years
Office equipment	4 to 8 years
Machinery and equipment	4 years

E. Capitalized Interest

Interest cost for assets that require time to bring them to the condition and location necessary for their intended use is capitalized as part of the asset cost until such time as the assets are placed in service. The Company capitalized interest of \$94,847 for the year ended December 31, 2013.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements
December 31, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

F. Taxes

The Company is responsible for gross receipt taxes, sales taxes and import taxes on its operations in the FSM.

G. New Accounting Standards

During the year ended December 31, 2014, the Company implemented the following pronouncements:

- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of the Company.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of the Company.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements
December 31, 2014 and 2013

2) Summary of Significant Accounting Policies, Continued

H. Management Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

I. Vital's Accounting Policies

Receivable. Receivables are uncollected amounts from Guam Power Authority (GPA) (see note 9) and FSMPC. As of December 31, 2014 and 2013, the Company has \$106,880 and \$61,511, respectively, receivable from FSMPC. Allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. Accounts deemed uncollectible are written-off. At December 31, 2014 and 2013, Vital is of opinion that an allowance for doubtful accounts is not required.

Property and Equipment. The Company capitalizes individual items with estimated useful lives of more than one year without regard to a capitalization threshold. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Motor vehicles	5 years
Computer equipment	5 years
Furniture and fixtures	7 years
Machinery and equipment	7 years

Taxes. The Company is taxed by and files its income tax return in Guam. The Guam income tax code is similar to that of the United States of America.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period that includes the enactment date.

The Company has net operating loss carryforwards of \$58,541 and \$18,470 for the years ended December 31, 2014 and 2013, respectively, which are available for Guam income tax purposes to offset taxable income of future periods. The carryover losses will expire on December 31, 2034 and 2033, respectively.

At December 31, 2014 and 2013, the Company has not recognized deferred tax assets resulting from net operating loss carryforwards because the Company believes that it is more likely than not that the tax benefit will not be realized.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

2) Summary of Significant Accounting Policies, Continued

I. Vital's Accounting Policies, Continued

For Guam income tax purposes, a tax year generally remains open to assessment and collection for three years after the later of the due date for filing a tax return or the date on which the tax payer files its return.

(3) Capital Assets

FSM Petroleum Corporation

Capital asset activities for the years ended December 31, 2014 and 2013 are as follows:

	<u>Balance at</u> <u>January 1, 2014</u>	<u>Transfers</u> <u>and Additions</u>	<u>Transfers</u> <u>and Deletions</u>	<u>Balance at</u> <u>December 31, 2014</u>
Buildings	\$ 687,297	\$ 113,037	\$ -	\$ 800,334
Motor vehicles	1,017,745	-	-	1,017,745
Plant and equipment	9,379,040	1,507,744	-	10,886,784
Furniture and fixtures	88,881	120,061	-	208,942
Office equipment	2,692,428	1,180,188	-	3,872,616
Machinery and equipment	<u>644,411</u>	<u>30,577</u>	<u>-</u>	<u>674,988</u>
	14,509,802	2,951,607	-	17,461,409
Less accumulated depreciation	<u>(3,769,516)</u>	<u>(1,445,221)</u>	<u>-</u>	<u>(5,214,737)</u>
	10,740,286	1,506,386	-	12,246,672
Construction in progress	<u>4,985,403</u>	<u>2,689,931</u>	<u>(3,229,531)</u>	<u>4,445,803</u>
	<u>\$ 15,725,689</u>	<u>\$ 4,196,317</u>	<u>\$ (3,229,531)</u>	<u>\$ 16,692,475</u>
	<u>Balance at</u> <u>January 1, 2013</u>	<u>Transfers</u> <u>and Additions</u>	<u>Transfers</u> <u>and Deletions</u>	<u>Balance at</u> <u>December 31, 2013</u>
Buildings	\$ 573,040	\$ 203,875	\$ (89,618)	\$ 687,297
Motor vehicles	807,176	262,674	(52,105)	1,017,745
Plant and equipment	5,509,593	3,869,447	-	9,379,040
Furniture and fixtures	88,881	-	-	88,881
Office equipment	2,156,712	535,716	-	2,692,428
Machinery and equipment	<u>495,260</u>	<u>154,316</u>	<u>(5,165)</u>	<u>644,411</u>
	9,630,662	5,026,028	(146,888)	14,509,802
Less accumulated depreciation	<u>(2,833,782)</u>	<u>(935,734)</u>	<u>-</u>	<u>(3,769,516)</u>
	6,796,880	4,090,294	(146,888)	10,740,286
Construction in progress	<u>5,320,502</u>	<u>4,530,064</u>	<u>(4,865,163)</u>	<u>4,985,403</u>
	<u>\$ 12,117,382</u>	<u>\$ 8,620,358</u>	<u>\$ (5,012,051)</u>	<u>\$ 15,725,689</u>

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

(3) Capital Assets, Continued

Vital Energy, Inc.

Capital asset activities for the years ended December 31, 2014 and 2013 are as follows:

	Balance at January <u>1, 2014</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at December <u>31, 2014</u>
Motor vehicles	\$ 25,258	\$ 7,900	\$ -	\$ 33,158
Computer equipment	33,363	4,939	-	38,302
Furniture and fixtures	9,741	-	-	9,741
Machinery and equipment	<u>19,168</u>	<u>1,775</u>	<u>-</u>	<u>20,943</u>
	87,530	14,614	-	102,144
Less accumulated depreciation	<u>(20,633)</u>	<u>(18,094)</u>	<u>-</u>	<u>(38,727)</u>
	<u>\$ 66,897</u>	<u>\$ (3,480)</u>	<u>\$ -</u>	<u>\$ 63,417</u>
	Balance at January <u>1, 2013</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at December <u>31, 2013</u>
Motor vehicles	\$ 25,258	\$ -	\$ -	\$ 25,258
Computer equipment	21,940	11,423	-	33,363
Furniture and fixtures	9,741	-	-	9,741
Machinery and equipment	<u>11,954</u>	<u>7,214</u>	<u>-</u>	<u>19,168</u>
	68,893	18,637	-	87,530
Less accumulated depreciation	<u>(7,202)</u>	<u>(13,431)</u>	<u>-</u>	<u>(20,633)</u>
	<u>\$ 61,691</u>	<u>\$ 5,206</u>	<u>\$ -</u>	<u>\$ 66,897</u>

(4) Due to States and Primary Government

In 2008, the FSMNG was extended a ¥200,000,000 grant by the Government of Japan (“the Grant”). The Grant and accrued interest shall be used by FSMNG properly and exclusively for the purchase of products enumerated in a list to be mutually agreed upon between the two governments. The Grant will be received by FSMNG in Yen currency, will be used as described above within a period of twelve months and any excess amounts will be refunded to the Government of Japan thereafter. FSMNG is required to deposit in Micronesian currency (US dollars) all the proceeds from the sale and lease of the products purchased referred to above. The amount of the proceeds to be deposited shall not be less than half of the total yen disbursement paid with respect to the purchase of the products. The deposit shall be made within the period of three years from the date of entry into force of the understanding between the two governments. The deposited fund shall be utilized for economic and social development purposes in FSM.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

(4) Due to States and Primary Government, Continued

In 2009, FSMPC signed a memorandum of agreement with FSMNG that the Grant be utilized for the supply of petroleum fuels to FSMPC to assist in the implementation of a number of initiatives aimed at mitigating the social and economic difficulties caused by volatile and sustained high oil prices. The Grant was paid directly by the Government of Japan through an independent procurement agent, Crown Agents, to FSMPC's supplier of fuel instead of to FSMNG. FSMPC has received the equivalent gallons of fuel from the supplier and this is now maintained as strategic inventory in each State. As of December 31, 2014 and 2013, FSMPC recognized a liability to the States and FSMNG of \$1,784,049.

At December 31, 2014 and 2013, the remaining \$500,000 in due to primary government represents non-interest bearing advance from the FSMNG. There is no specific repayment terms and management has classified the advance as long-term since it has no expectation that such will have to be repaid before December 31, 2014. The advance has been deposited in a bank account, which is presented as restricted cash in the accompanying statements of net position.

(5) Long-term Debt

Long-term debt represented balance outstanding on a bank note payable for purposes of acquiring capital assets, due in monthly installments of \$57,949, with interest at 7% per annum, and unconditionally guaranteed by the FSM National Government. This loan was fully paid during the year ended December 31, 2014.

(6) Short-Term Borrowings

As of December 31, 2014 and 2013, the Company has a bank line of credit facility (LOC) of \$10,000,000 currently expiring on June 30, 2015. This LOC is utilized by the Company to fund fuel inventory purchases. The LOC and the related long-term obligation are secured and collateralized by an executed Pledge and Security Agreement for the assignment of the Reserve Bank Account and Revenue, an executed Notice of Security Interest and Chattel Mortgage and are guaranteed by the FSM National Government.

Borrowings against the LOC bear interest at the Bank's effective reference rate plus 0.75%, with minimum rate of 7% per annum and decreased to 5.75% per annum on January 31, 2013, with interest payable monthly and principal due within 180 days. No borrowings are outstanding against the LOC at December 31, 2014 and 2013.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

(7) Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2013 are as follows:

	Balance at January 1, <u>2014</u>	<u>Additions</u>	<u>Repayments</u>	Balance at December 31, <u>2014</u>	Due Within <u>One Year</u>
Note payable	\$ 703,962	\$ -	\$ (703,962)	\$ -	\$ -
Due to states and primary government	<u>2,284,049</u>	-	-	<u>2,284,049</u>	-
	<u>\$ 2,988,011</u>	\$ -	\$ (703,962)	<u>\$ 2,284,049</u>	<u>\$ -</u>

Changes in long-term liabilities for the year ended December 31, 2013 are as follows:

	Balance at January 1, <u>2013</u>	<u>Additions</u>	<u>Repayments</u>	Balance at December 31, <u>2013</u>	Due Within <u>One Year</u>
Note payable	\$ 1,806,783	\$ -	\$ (1,102,821)	\$ 703,962	\$ 667,352
Due to states and primary government	<u>2,427,518</u>	-	(143,469)	<u>2,284,049</u>	-
	<u>\$ 4,234,301</u>	\$ -	\$ (1,246,290)	<u>\$ 2,988,011</u>	<u>\$ 667,352</u>

(8) Risk Management

The Company purchases commercial insurance to cover its potential risks from refueling operations, inventory and facilities. It also maintains workmen's compensation coverage. It is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice during the past three years.

(9) Significant Customers

FSM Petroleum Corporation

Revenue from one major customer, Pohnpei Utilities Corporation, for the years ended December 31, 2014 and 2013 approximated 19% and 18%, respectively, of the Company's total revenue, and receivable of \$448,824 and \$526,320 as of December 31, 2014 and 2013, respectively.

The Company purchased substantially all fuel from one supplier in 2014 and 2013.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements
December 31, 2014 and 2013

(9) Significant Customers, Continued

Vital Energy, Inc., Continued

Vital has a contract with the Guam Power Authority (GPA) to manage, operate and maintain GPA's fuel bulk storage facility from June 1, 2012 to May 31, 2015. GPA elected to extend the contract for an additional two-year term. The contract is for an annual fixed fee of \$675,273 payable by GPA monthly. The Company is required to seek approval from GPA for all major operation and maintenance activities exceeding \$5,000 which are to be billed separately from monthly payments. Service fee revenue of \$747,471 and \$737,082 presented in the accompanying statements of revenue, expenses and changes in net position was earned from the GPA contract for the years ended December 31 2014 and 2013, respectively. As of December 31, 2014 and 2013, the Company has \$112,546 and \$127,193 receivable from GPA, respectively.

(10) Commitments and Contingencies

Leases

The Company leases land, warehouse, airport facilities and other such space through various leases expiring through 2027. Certain lease agreements contain options to renew with rent escalations. Three lease agreements require additional lease payments contingent on the level of gallons sold by the Company from that leased facility.

Future minimum lease payments are as follows:

<u>Year Ending December 31,</u>	
2015	\$ 430,074
2016	424,254
2017	406,254
2018	409,254
2019	412,254
2020-2024	1,126,025
2025-2027	<u>240,000</u>
	\$ <u>3,448,115</u>

Sales

The Company has entered into agreements to sell fuel at an agreed pricing method. The agreements are for one year and automatically renew at the end of their respective terms every 30 days unless terminated by either party.

Letter of Credit

A stand-by letter of credit of \$675,274 is issued in favor of GPA to satisfy Vital's required performance bond related to the contract described in note 9. The letter of credit will expire on April 17, 2016.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
December 31, 2014 and 2013

(11) Coconut Development Unit (CDU)

CDU was established through Public Law (P.L.) No. 18-68 enacted on June 16, 2014, which dissolved the FSM Coconut Development Authority (CDA) and transferred the responsibility of coconut development to FSMPC. CDU is a division of FSMPC. Pursuant to P.L. 18-68, the transition will occur in several phases over the next 24 months. Phase I was started since June 2014 with the goal of ensuring a seamless transition of CDA employees and assets by September 30, 2014. As of December 31, 2014, FSMPC contributed \$249,023 to the establishment of CDU, which is recorded as "Due from CDU" account. CDU's financial position and activities as of and for the period ended December 31, 2014 are not material to FSMPC's financials; therefore, such are excluded from FSMPC's financial statements as of and for the year ended December 31, 2014. Future operations of CDU will be recorded commencing January 1, 2015.

(12) Related Parties

FSMPC sells fuel to the four utilities company in the FSM namely: Pohnpei Utilities Corporation, Chuuk Public Utility Corporation, Kosrae Utility Authority, and Yap State Public Corporation. Total fuel sales of \$20.7 million and \$22.1 million was earned from the four utilities company for the years ended December 31, 2014 and 2013, respectively. As of December 31, 2014 and 2013, FSMPC has total receivables of \$1.6 million and \$1.8 million, respectively, from those four utilities company.

(13) Subsequent Events

In January 2015, FSMPC established a restricted fund reserve of \$2 million investments managed by an independent investment and financial services firm. The fund will provide self-funding mechanism for increased employee personnel costs. Further, FSMPC received \$1 million fuel purchase deposit from one customer in May 2015.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

The Board of Directors
Federated States of Micronesia Petroleum Corporation:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Federated States of Micronesia Petroleum Corporation (the Company), which comprise the statement of net position as of December 31, 2014, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 22, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in accompanying Schedule of Findings and Responses as item 2014-002 that we consider to be significant deficiencies.

Compliance and Other Matters

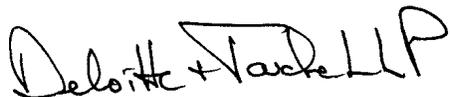
As part of obtaining reasonable assurance about whether the financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as item 2014-001.

The Company's Response to Findings

The Company's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 22, 2015

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Schedule of Findings and Responses
Year Ended December 31, 2014

Finding No.: 2014-001

Procurement Documents

Criteria: Procurement transactions shall provide for full and open competition that is best suited to the circumstances.

Condition: Procurement documents evidencing full and open competition or vendor selection were not provided for all eleven expenditures tested aggregating \$433,821. Details follow:

<u>#</u>	<u>Project</u>	<u>Voucher No.</u>	<u>Date</u>	<u>Amount</u>
1	COR13-1801	21733	9/16/2014	\$ 18,439
2	COR14-0601	18059	4/23/2014	51,125
3	COR14-0602	22770	10/27/2014	80,000
4	YAP13-0303	22236	10/10/2014	14,355
5	PNI14-0104	18687	5/29/2014	107,728
6	PNI13-0201	16915	2/18/2014	107,729
7	KSA11-0101	19479	7/11/2014	9,587
8	KSA11-0104	18613	5/27/2014	2,400
9	COR12-1501	12588	6/30/2013	4,500
10	COR12-1501	12589	6/30/2013	<u>4,200</u>
				\$ <u>400,063</u>

Cause: The cause of the above condition is lack of established procurement policies and regulations.

Effect: The effect of the above condition is potential noncompliance with competitive procurement.

Recommendation: We recommend that the Company complete a procurement manual entailing standard procedures to maximize full and open competition.

Prior Year Status: The lack of procurement documentation was reported as a finding in the audits of the Company in 2012 and 2013.

Auditee Response and Corrective Action Plan: Management acknowledges that there is need to improve our procurement process. That is why FSMPC has entered into contract with Ultima Training & Consulting Services to develop the Procurement Policies and Procedures. This procurement process will include documentation, selection of vendors, purchasing, and warehousing (receiving and insurance).

Management expects to roll this procurement process in August 2015, and we believe this will be able to address the weaknesses cited in this audit.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Schedule of Findings and Responses
Year Ended December 31, 2014

Finding No.: 2014-002

Construction-in-Progress (CIP) Project Monitoring

Criteria: An effective system of internal control includes policies and procedures related to periodic monitoring of capital project status that includes coordination between project management and the finance and accounting personnel.

Condition: Four of ten CIP projects tested could not provide a project status report or equivalent documentation. Details follow:

<u>#</u>	<u>Project</u>	<u>Amount</u>
1	COR13-1801	\$ 400,920
2	COR14-0601	179,571
3	COR14-0602	85,220
4	YAP11-01	<u>200,937</u>
		\$ <u>866,648</u>

Further, a number of open projects with no recent costs incurred was noted as of December 31, 2014.

Cause: The cause of the above condition is lack of periodic monitoring of capital projects status between project management and accounting personnel.

Effect: The effect of the above condition is a potential misstatement of capitalized assets and related expenses.

Recommendation: We recommend that management conduct a comprehensive and periodic review of the stage of completion of the CIP projects. Quarterly reports as to percentage of completion should be obtained from the project head. Further, FSMPC should review all project codes to determine those that are no longer relevant and valid.

Prior Year Status: The lack of periodic monitoring of capital projects status between project management and accounting personnel was reported as a finding in the audit of the Company in 2013.

Auditee Response and Corrective Action Plan: Management believes that the implementation of the procurement process mentioned in finding no. 001 above, will also address the inequities noted in the audit finding, especially in the selection of vendors and purchasing of materials to complete the projects, hopefully in time.

However, Finance will work with the Project Managers and updates and assist the project managers to close the projects on time.

**FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Unresolved Prior Year Findings
Year Ended December 31, 2014

Summary Schedule of Prior Audit Findings

Findings relating to the financial statements, which are required to be reported in accordance with GAGAS:

Finding No. 2012 – 01, Procurement Documents – Not corrected. Refer to Finding No. 2014-001.

Finding No. 2013 – 01, Procurement Documents – Not corrected. Refer to Finding No. 2014-001.

Finding No. 2013 – 02, CIP Project Monitoring – Not corrected. Refer to Finding No. 2014-002.